

Special Report

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**Office of Inspector General**

Study of the Benefits of the Office of Inspector General  
Establishing a Fraud Hotline

June 2006

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Office of Inspector General  
Montgomery County, Maryland

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June 30, 2006

George Leventhal, President, County Council  
Douglas M. Duncan, County Executive

Gentlemen:

We conducted a study to determine the benefits of establishing an independent Office of Inspector General (OIG) fraud hotline for Montgomery County. A fraud hotline was included as an action item in our August 2005 Four-Year Work Plan to help fulfill our legislative mandate to prevent and detect fraud, waste, and abuse and propose ways to increase legal, fiscal, and ethical accountability. The Plan also included examining the adequacy of administrative and legal protection for whistleblowers. Accordingly, we are submitting this report which includes our methodology of study, background information, best practices, benefits, costs, and recommendations.

In summary, we found there is a trend among government agencies to establish hotlines as a deterrent to fraud and to send a positive message to all employees and residents about leadership's commitment to protect public resources. In its 2004 *Report to the Nation on Occupational Fraud and Abuse*, the Association of Certified Fraud Examiners (ACFE) found that agencies detect fraud most often through a tip. The report concluded one of the best ways to gather vital information about possible fraud is through an independent hotline capable of providing anonymity to callers, if desired.

Because Montgomery County leaders have an ongoing interest in maintaining an ethical work environment and because of the potential value of an independent hotline to improve County government's capabilities to uncover fraud, waste, and abuse, the OIG plans to implement a hotline in fiscal year 2007 on a one-year trial basis. Our plan has been discussed with and has the support of Executive leadership as well as Council members. We estimate fiscal year 2007 costs, using existing OIG staff, will not exceed \$17,000 and expect the costs to come from our authorized budget.

Regarding whistleblower protection and related matters, certain amendments to Montgomery County Code §33-10 (the County's whistleblower statute) may be necessary to help ensure the effectiveness of an OIG-operated hotline. This is because Section 33-10 was enacted by the Council prior to creating an OIG in 1997.

Throughout the one-year trial period, the OIG will update you on our progress to develop and implement the necessary procedures for an effective hotline.

Respectfully submitted,

Thomas J. Dagley  
Inspector General

# Office of Inspector General

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## **Methodology of Study**

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To conduct this study, we analyzed hotline activities of federal, state, county, and other public sector agencies. We identified those agencies from several sources, including the American Institute of Certified Public Accountants (AICPA), the Association of Inspectors General (AIG), and the Association of Certified Fraud Examiners (ACFE). For example, we reviewed pertinent information from Maryland's Office of Legislative Audits - Department of Legislative Services and the Maryland-National Capital Park and Planning Commission, who operate or plan to operate fraud hotlines in fiscal year 2007. Throughout the study, we used the Internet to identify and evaluate fraud hotlines in operation in public sector and private organizations.

In addition, we discussed an OIG-operated hotline with: the County's external auditor; members of the County Council Management & Fiscal Policy Committee; Assistant Chief Administrative Officers; the Director and Chief-Internal Audit, Department of Finance; and third-party contractors who provide fraud hotline services to public sector and private organizations nationwide.

We also conducted an independent review of the County's whistleblower law (Montgomery County Code Section 33-10) and County Personnel Regulations. Our intent was to evaluate the effectiveness of provisions designed to protect the whistleblower or to make an employee more likely to report potential occurrences of fraud, waste, and abuse to an independent Office of Inspector General (OIG).

Our study did not constitute an audit conducted in accordance with generally accepted government auditing standards.

## **Background Information**

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### **Statutory Responsibilities**

The OIG was established by the Montgomery County Council in 1997. The OIG is an independent office – its responsibilities as prescribed by Montgomery County Code §2-151 are:

1. Review the effectiveness and efficiency of programs and operations of County government and independent County agencies.
2. Prevent and detect fraud, waste, and abuse in government activities.
3. Propose ways to increase the legal, fiscal, and ethical accountability of County government and County-funded agencies<sup>1/</sup>.

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<sup>1/</sup> The County-funded agencies include the Montgomery County Public Schools, the Maryland-National Capital Park and Planning Commission, the Washington Suburban Sanitary Commission, Montgomery College, the Housing Opportunities Commission, the Revenue Authority, and any other governmental agency (except a municipal government or a State-created taxing district) for which the County Council appropriates or approves funding, sets tax rates, or approves programs or budgets.

To carry out our responsibilities, we:

- Maintain independence while planning and conducting audits, inspections, and investigations; comply with generally accepted government auditing standards, as applicable; and use standards published by the Association of Inspectors General (AIG), Institute of Internal Auditors (IIA), and President's Council on Integrity and Efficiency (PCIE).
- Take appropriate action to prevent and detect fraud, waste, and abuse.
- Receive and investigate credible complaints from any person or entity.
- Report violations of law to the State's Attorney for Montgomery County or other appropriate agencies.
- Notify the Council, Executive, and other leaders of serious problems in County and County-funded programs.
- Review existing and proposed legislation and regulations to strengthen controls and increase accountability.
- Submit reports with recommendations, as appropriate, to the Council and Executive.

In a memorandum dated May 25, 2006, the Council President advised it is the Council's view that if a fraud hotline is a high priority for the OIG and if there is sufficient room within the approved budget, the Inspector General should feel free to implement a fraud hotline.

#### **Four-Year Work Plan—Ideas Worth Exploring**

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In August 2005, the OIG issued a required Four-Year Work Plan for fiscal years 2006-2009 (this Plan can be accessed via <http://www.montgomerycountymd.gov>). In the Plan, we recommended establishing and promoting a formal fraud-referral system (including a hotline) to help strengthen the County's governance system by providing employees, contractors, and residents a mechanism to report suspected fraud, waste, and abuse in County government and County-funded agencies. Respondents to a 2004 survey by the ACFE revealed that various forms of fraud are detected 40 percent of the time by tips, which make an independent hotline a leading method for detecting fraud. In our Plan, we reported that although there were fraud-referral processes in use in County operations, none appeared to operate in a manner consistent with all key standards recommended by the ACFE, the Government Finance Officers Association, and other professional organizations. We reported employees, contractors, suppliers, and residents should be encouraged and given the means to communicate concerns, anonymously if desired, without fear of retribution.

Two other ideas were included in the Plan that may impact the effectiveness of an OIG hotline:

- We recommended consideration be given to establishing an injury compensation working group that includes the OIG to help control increasing costs associated with workers' compensation claims. We reported that based on the effectiveness

of fraud hotlines operated by other inspectors general, an independent County hotline has the potential to help prevent and detect abuse in the workers' compensation program.

- We noted County Personnel Regulations state that potentially illegal or improper actions in government activities should be reported to an appropriate official to investigate or take corrective action. However, investigative responsibility for allegations of serious misconduct that include criminality is not specified. We recommended consideration be given to establishing a working group that includes the OIG to clarify investigative responsibilities for all allegations that include criminality. This could help clarify employee reporting procedures to ensure such allegations are independently investigated and reported to the appropriate official(s) for a decision regarding what, if any, action should be taken.

### **Best Practices/Key Success Factors**

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There are several reliable sources of information regarding key success factors for fraud hotlines. These sources include the ACFE, AICPA, IIA, and AIG. Highlighted below are factors that these and other professional organizations increasingly report as best practices:

- Cultivate a vigorous whistleblower program. Use proven feedback channels such as a dedicated phone number to provide a confidential way for employees, vendors, contractors, and other stakeholders to report concerns from work or other locations.
- Expedite the distribution of reported information for timely independent evaluation by individuals whose only criteria is to find the facts. Ensure complaints involving supervisors or managers are not filtered.
- Establish a hotline that allows caller anonymity and protects confidentiality. The power of a hotline lies in its ability to open lines of communication.
- Staff the hotline 24/7 with trained interviewers. Interviewers should have specialized training to help callers thoroughly cover their concern.
- Ensure a hotline with multi-lingual capability.
- Use a unique identification number to enable callers to call back later anonymously.
- Use a case management system to ensure all allegations and callbacks are logged.
- Distribute educational materials to raise awareness among potential users and explain how to report information.
- Ensure legal compliance regarding whistleblower and privacy protection.
- Ensure hotline procedures are periodically evaluated by an external peer review team.

With regard to the above factors, we believe the best approach is for the OIG to contract with a third-party partner who provides a customized toll-free number and other client-specific hotline services. Accordingly, we plan to use the County's informal procurement process to select a contractor for a one-year trial period. During the trial period, a 24-hour hotline number will be promoted and individuals will be encouraged to use the

hotline to report allegations of fraud, waste, and abuse involving County government operations. We anticipate that hotline services will include the referral of caller information to the OIG daily for evaluation.

## **Benefits**

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Three primary benefits of an independent fraud-referral system for County government are: preventing improper or illegal activity from occurring; detecting violations of law or County policy in a timely manner; and responding appropriately once fraud, waste, or abuse is discovered. We anticipate that as a result of implementing a fraud hotline, there will be a modest increase in the number of complaints received by the OIG, when compared to OIG activity in fiscal years 2004 to 2006. In addition, an OIG-operated hotline can help County leaders comply with current and future governance requirements regarding internal controls, ethics, and performance management. Further, a fraud hotline can help demonstrate due diligence and reduce liability.

Recognizing that all benefits of an OIG-operated fraud hotline will be difficult to quantify, we are committed to sharing with Executive leaders and Council members the information necessary to evaluate the hotline's overall effectiveness while, at the same time, protecting caller confidentiality. The OIG will summarize hotline activity in its fiscal year 2007 annual report.

We found that while some organizations provide hotline services internally, there may be serious drawbacks to this approach. When operated internally, calls to hotlines are typically routed to an employee in internal audit, human resources, or ethics. If employees realize they must call an internal number (possibly from an internal phone), they may fear that their identity will be traced and decide not to call. In addition, operational problems may exist such as callers encountering voice mail and being reluctant to leave a message or provide important details.

If employees believe information they provide through an internal or third-party hotline will end up in the hands of someone not considered independent, organizations may be vulnerable to charges of covering up issues.

## **Costs**

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Our study regarding costs incurred by public sector organizations comparable to Montgomery County government was limited. We found that detailed records of hotline operating costs are not readily available or not prepared using a formal cost/benefit analysis. We believe this is consistent with the view that a hotline's inherent value is that it acts as a deterrent and is a visible sign of leadership's commitment to prevent and detect fraud, waste, and abuse.

Reputable third-party contractors who provide hotline services to multiple clients tend to do a better job than parent organizations when addressing key success factors. While there will be County costs associated with a third-party contractor, they will be relatively small when considering County government already has an independent OIG structure in



place as part of its governance system. We estimate that the costs for the trial period will not exceed the maximum authorized for an informal procurement solicitation and the costs will come from the Inspector General's fiscal year 2007 budget.

## **Challenges**

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A potential barrier to establishing and maintaining an effective OIG hotline is Montgomery County Code Section 33-10 (the County's whistleblower law). Section 33-10 was enacted prior to the creation of an Office of Inspector General in 1997. As a result, Section 33-10 states, in part, "employees should first report illegal or improper actions to the individual responsible for corrective action. That person may be anyone from the employee's immediate supervisor up to and including the County Executive, or for legislative branch employees, the County Council." Section 33-10 also states, in part, "in unusual circumstances, or if a retaliatory action or coercion has taken place, the employee may file a report directly with either the Board [*Merit System Protection Board*] or the Ethics Commission."

We believe the County Code is inadequate because it does not sufficiently clarify employee responsibilities to report fraud, waste, and abuse in County government to the OIG.

## **Recommendations**

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Because of the potential benefits, the Office of Inspector General plans to implement a fraud hotline using a third-party contractor for a one-year trial period beginning in fiscal year 2007. In this regard, we recommend:

- The County Council, in consultation with the Executive, consider amending County Code including Section 33-10 to clarify employee protections and responsibilities to report fraud, waste, and abuse to the OIG to enhance the effectiveness of an OIG-operated fraud hotline. We recommend that any amendments be completed no later than the Council's approval of the OIG fiscal year 2008 budget.
- The County Executive, in consultation with the Council, consider revising County Personnel Regulations, including Section 3-2, in support of an OIG-operated fraud hotline. We recommend any revisions be completed no later than the start of fiscal year 2008.

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